

CHAPTER 15PREVENTING, DETECTING, AND REPORTING
- AND ILLEGAL ACTSA. PURPOSE

This chapter establishes policy in **auditing** areas susceptible to **fraud** and illegal acts and **in** alerting **auditors** that such acts may have **occurred**. It supersedes the internal **audit** provisions **contained** in Contract **Audit**, Internal **Audit** and Criminal Investigations Joint Policy **Memorandum** No. 2 (reference **(rr)**). The Joint Policy **Memorandum** will **no** longer apply to **DoD** internal audit organizations, but its **applicability** to criminal investigative organizations continues.

B. APPLICABILITY

All **DoD** internal **audit** organizations including internal review and **nonappropriated** fund audit activities shall **comply** with **applicable** provisions in this chapter.

C. DEFINITIONS

1. Fraud. Action that violates a fraud-related statute of the **United** States Code. The term includes Government theft/**embezzlement**, bribery, gratuities, **conflicts** of interest, and violations of antitrust laws, as **well** as fraud (e.g., false statements and false claim) in such areas as pay and **allowances**, procurement, contract **performance**, **nonappropriated** funds, and the Civilian Health and Medical Program of the Uniformed Services. Fraud involves a misrepresentation of facts made so with knowledge and intent. Fraud is further characterized by acts of guile, deceit, **concealment**, or breach of confidence, which are used to gain some unfair or dishonest advantage. Fraud can also include deceit or intentional false statements in official correspondence intended to affect the decision making process regardless of whether personal gain is involved. The purpose of the fraud may **be** to obtain **money**, property, or services; to avoid **payment** or loss of money, property, or services; or to secure business or personal advantage.

2. Illegal Act. A **type** of **noncompliance** in which **the** source of the requirement not **followed** or the prohibition violated is a statute or implementing regulation. Enclosure 4 contains information on Federal statutes and Standards of **Conduct** regulations that **may** be applicable in the **auditor's** examination and the fraud referral process.

a. Criminal Acts. An illegal act for which incarceration, as well as other penalties, is available if the Government obtains a guilty verdict.

b. Civil Acts. An illegal act for which penalties that do not include incarceration are available for a statutory violation. Penalties may include monetary **payments** and corrective actions.

3. Referral. The term relates to **formal** (written) letters to appropriate criminal investigative organizations of suspicions of fraud and **illegal acts**.

The purpose of such **communications** must be to seek consideration of the facts (as stated by the audit organization in its letter) for investigative action where warranted.

D. **POLICY**

1. The **DoD** internal **audit** organizations shall establish a fraud monitor at the headquarters level for fraud referrals and other **f raud-related** actions. The **fraud** monitor shall maintain liaison with the applicable investigative organizations regarding the status of all referrals.

2. Internal **auditors** shall give special emphasis to those portions of **the DoD** Internal Auditing Standards (Chapter 2) relating to **f raud** and illegal acts.

3. During every **audit**, a review and evaluation shall be made of the internal control system applicable to the organization, **program**, activity, **or** function under **audit**. When **computer** processed data is an important and integral part of the audit and the data's reliability is crucial to **accomplishing** the audit objectives, the **auditors** need to satisfy themselves that the data is reliable.

4. Where an **auditor's** work includes an assessment of **compliance** with laws and regulations, it shall be designed to provide reasonable assurance of detecting fraud or illegal acts that could significantly affect the audit objectives.

5. **Auditors**, in exercising due professional care, shall be alert for situations or transactions that could indicate **f raud** or illegal acts to determine whether the acts occurred and, if so, to determine the extent to which these acts significantly affect the audit results. Where such evidence exists, the auditors shall extend audit steps and procedures to identify the effect on the entity's financial statements, operations, or programs. However, auditors should not extend **audit** steps to the **point** of jeopardizing potential investigations by law enforcement officials.

6. When the review or the extended audit steps and procedures indicate that fraud or other criminal acts may have occurred, the auditor shall **document** the situation and **promptly** notify the appropriate **DoD** investigative organization as indicated by **DoD Instruction** 5505.2 (**reference** (ss)). Following notification of the investigators, the auditor shall **notify** the top official of the entity under audit of the situation, unless advised otherwise by investigators **or** it is obviously inappropriate (e.g., top official involved) .

7. The method of **reporting** the audit results will vary depending upon individual **circumstances**. Audit matters dealing with **f raud** or irregularities shall be covered in a separate written audit report if this would facilitate the timely issuance of an overall report on other aspects of the audit. The opinion of legal counsel should be obtained on the reporting method chosen.

8. The **DoD** **audit** organizations shall encourage direct contact between their field personnel and personnel of the applicable criminal investigative organization concerning referrals of suspected or potential **f raud** disclosed during audits. The audit organization's fraud **monitor** must be kept apprised of referrals in order to track the status of fraud investigations resulting from audit referrals.

9. Should the applicable criminal investigative organization decide not to investigate a fraud referral **from** auditors, nor refer **the** allegations elsewhere for investigation (in cases where the allegations are considered to be of lesser significance, for example), the audit organizations, upon notification by the criminal investigative organization, should then evaluate the matter for other disposition. Procedures for referring allegations of this type were required to be established by **individual DoD Components** as called for in paragraph E. 2. f. of reference (ss). **Audit** organizations shall make **disposition** of the allegation in accordance with their **Component's** procedures.

10. Appropriate audit support of criminal investigations is authorized under DoD Directive 7600.2 (reference (k)) , and is encouraged to the greatest extent possible within legal limitations, availability of resources, and the guidelines set forth in **enclosure 2**. Further, **DoD** internal audit organizations are strongly encouraged to work with their criminal investigative counterpart organizations to exchange information on situations discovered during audits where, although no fraud may be **suspected**, weaknesses in controls and procedures could lead to incidents of fraud.

E. FRAUD INDICATORS AND CHARACTERISTICS

1. **Fraud** encompasses the entire array of illegal acts and irregularities, and is characterized by intentional deception or manipulation with adverse effects. Fraud can be perpetrated for the benefit of, or to the detriment of, the organization, Agency, or activity and can be carried out by a **person** or **persons** outside as well as inside the entity. In some instances involving civil fraud, **fraud** can be **alleged** where the negligence of an individual is so gross as to **amount** to implied **knowledge** of the wrongfulness of the act.

2. The key to prevention and detection of fraud and illegal acts **is** a recognition of conditions that **allow** these practices to go undetected. As such, the auditor has the responsibility for being aware of fraud indicators. Several sources are available for information on **fraud** and indicators of fraud. Some of these sources are listed in enclosure 1 to this chapter. The **following** warning signals were developed by the **American** Institute of Certified Public Accountants to assist auditors in identifying the possible existence of fraud:

a. Problems encountered in performance of an examination, such as delay situations or evasive or unreasonable responses to audit inquiries.

b. Difficulty in obtaining **audit** evidence for unusual or unexplained entries, **incomplete or** missing **documentation** and authorizations, and alteration of **documents** and accounts.

c. Inadequate controls over cash accounts or credit cards.

d. Unexplained fluctuations in material **account** balances, physical inventory variances, and inventory **turnover** rates.

e. Widely dispersed locations accompanied by highly decentralized management and inadequate reporting systems.

f. Known continuing weaknesses in internal controls over access to **computer equipment** or electronic data entry devices.

F. PREVENTION AND DETECTION

1. The principal mechanism for the prevention and detection of fraud and illegal acts is a strong system of accounting and administrative internal controls. Deterrence or prevention is primarily the responsibility of the management of the organization, program, activity, or function under audit. The **OMB** Circular A-123 (reference (v)) states that agency heads are responsible for establishing and maintaining systems of internal control that conform to standards prescribed by the **Comptroller** General.

2. Internal auditors are **responsible** for examining and evaluating the adequacy and effectiveness of management's actions in deterring or preventing fraud, including appropriate internal control systems. Auditors should assess the effectiveness of the system to safeguard resources against waste, loss, or misuse. They shall test and evaluate management's applicable fraud deterrent mechanisms and make appropriate **recommendations** if weaknesses exist.

3. The internal auditor's responsibilities are further extended in the detection of fraud and illegal acts. On audit assignments, the internal auditor's responsibilities are to:

a. Maintain sufficient **knowledge** of the characteristics of fraud, techniques used to **commit fraud**, and the types of fraud associated with the activities being **audited**. Such **knowledge** is necessary for the auditor to be reasonably effective in determining the adequacy of controls to limit or discourage opportunities to **commit** fraud or illegal acts, and in evaluating evidence that these acts might have been **committed**. The sources of information on fraud and fraud indicators discussed in section E., above, and listed in enclosure 1 can reinforce the **auditor's** knowledge and skills. The **DoD** internal audit organizations should work closely with investigative organizations to develop additional information on the characteristics of fraud and fraud indicators and share it with other **DoD** internal audit organizations.

b. **Be** alert for situations or transactions that could indicate fraud and illegal acts. This is **especially** true when performing audits of such sensitive areas as pay, procurement, cash management, property disposal, nonappropriated funds, cannissaries, or inventories. In exercising due professional care, **auditors** should be alert to the possibilities of intentional **wrongdoing**, conflicts of interest, and conditions and activities where irregularities are **most** likely to occur. Accordingly, internal **auditors** need to satisfy themselves that a system of checks and balances is in place that will **disclose** any irregularities and improprieties that would have a material impact on operations or financial reporting. In discussing the auditor's **responsibility** to detect errors and irregularities, the American Institute of Certified Public Accountants (**AICPA**) has stated that "... the auditor should exercise . . . the proper degree of professional skepticism to achieve reasonable assurance that material errors or irregularities will be detected. " For additional guidance on related responsibilities, **auditors** should refer to **AICPA** Statements on **Auditing** Standards No. 53 ("The Auditors Responsibility to Detect and Report Errors and Irregularities") , No. 54 ("Illegal **Acts** by Clients") , and No. 55 ("Consideration of the Internal Control Structure in a Financial Statement Audit") .

c. Where assessment of **compliance** with laws and regulations is required as part of the audit objectives, auditors should design audit steps and procedures to provide reasonable assurance of detecting irregularities or illegal acts that could significantly affect the audit objectives. This requires the **auditor** to assess, for each **compliance** requirement, the risk that irregularities and illegal acts **could** occur.

d. Be alert to the opportunities for potential perpetrators to **commit** fraud or illegal acts. The DoD Directive 7600.2 (reference (k)) requires that each **audit** include an evaluation of the adequacy and effectiveness of the system of internal and administrative controls (internal controls) applicable to the organization, program, activity, or function under audit.

e. Include specific **audit** steps designed to provide reasonable assurance of detecting **fraud** for those programs or functions that have a high vulnerability to fraud or a past history of fraud, or where initial **audit** survey has identified particular weaknesses in internal controls that could allow fraudulent acts to occur. In addition to expanding audit **steps**, audit managers should also consider assigning more experienced **personnel** and increasing the amount of **audit** supervision where conditions warrant.

f. Where evidence exists that indicates fraud or illegal acts might have been **committed**, and such acts could significantly affect the audit results, internal auditors shall perform extended tests and procedures to obtain additional evidence sufficient to determine whether:

- (1) **The** initial suspicions of **fraud** were true;
- (2) The extent to which the acts significantly affect the audit results;
- (3) Operations, programs, or functions have been adversely affected;
- (4) **The** appropriate investigative organization should be alerted to a possible need for an investigation;
- (5) Internal controls need additional strengthening; and
- (6) Any further action appears necessary.

Auditors should, however, exercise due professional care and use caution so as not to extend tests to the point of jeopardizing potential investigations by legal authorities. Due care would **include** consulting legal counsel and the applicable investigative organizations, as appropriate, to determine the actions and procedures to follow or to avoid. If, after extending the **audit steps and** procedures, the internal auditors cannot confirm their suspicions of fraud, they should discuss the situation with the appropriate investigative organization to determine whether or not to pursue the situation.

g. Document the situation or particular transaction when the initial review or extended audit indicates possible fraud or other criminal acts and **promptly** notify the appropriate DoD investigative organization in accordance with DoD Directive 7600.2 (reference (k)) . Formal written notification is required for all fraud referrals **and will normally have been** preceded by informal

discussions with investigative personnel. At the same time, the auditors **shall** notify the top official of the audited entity, unless that official is believed to be a party to, or implicated in, the improper acts or unless the auditors are advised to the contrary by the investigative organization.

h. **Complete** the evaluation of the system of internal controls and the audit, if possible, so as not to interfere with or hamper any related investigation. The advice of the investigative activity should be **obtained** in determining how to **complete** the evaluation and report the results in a manner that will not **compromise** an investigation. **The** auditors should not accuse the affected parties of suspected fraud or discuss the potential fraud with the subject in any manner that **would** be pre **judicial** to an investigation. Legal counsel and the advice of investigators should also be sought on how to discuss the situation with the aff **ected** parties and obtain confirmation of the facts.

4. Internal auditors cannot be expected to have knowledge equivalent to an investigator whose responsibility is detecting f **raud** and other illegal acts. Also, an audit made in conformance with the provisions outlined in this chapter will not necessarily guarantee the discovery of all fraud or illegal acts that might have been **committed**. **However**, if the audit was made in accordance with this chapter, the auditor will have fulfilled the professional responsibilities expected.

G. REPORTING

1. The method of reporting audit results to appropriate management officials shall be guided by the situation and individual circumstances surrounding any suspected or potential f **raud** disclosed through **audit**. A separate **aud it report** on the evaluation of the internal controls related to the matter referred to the investigative agency shall be used, if necessary, to avoid delays in issuing the overall audit **report**. This also permits release of the overall report to the public without **compromising** an investigation or legal proceeding.

2. A separate report is not necessary when the matter can be effectively discussed in the regular report of audit, and no undue delay will result **from** holding the audit report open until the f **raud** referral has been resolved. The **auditors** shall not release to the public **reports** containing information on suspected f **raudulent** acts, **or** reports with references that such acts were omitted **from** reports, without first consulting with appropriate legal counsel, since this release could interfere with legal processes, subject the implicated individuals to undue publicity, or subject the **auditor** to potential legal action.

H. TRAINING

1. The problem of **fraud** in the Department of Defense has received widespread attention in recent years, and as the **budget** increases, the potential and the attractiveness of **committing** fraud also increase. Therefore, it is **incumbent** upon internal auditors to maintain and even enhance their detection abilities and skills in order to more effectively address these **problems**.

2. The **DoD** internal audit organizations **shall** provide training for their **audit** staffs consistent with **DoD** auditing standards on professional proficiency and continuing education. Specific fraud-related training should focus on detecting, preventing, and reporting f **raud** and illegal acts. The key to any

successful. training program is the recognition of the indicators of fraud. Chapter 4 of this manual suggests guidelines for training audit staffs in areas of fraud awareness and working with investigators.

I. DOD HOTLINE

1. Under DoD Directive 7050.1 (reference (tt)), all substantive allegations of fraud and mismanagement received by the DoD Hotline normally **will** be examined by qualified auditors, inspectors, or investigators. Accordingly, each DoD internal audit organization shall maintain procedures and controls to ensure that due professional care and organizational independence are observed, and that impartial and objective examinations are made for all referred Hotline **allegations.**

2. Each internal audit organization shall control, process, and examine promptly all allegations received and shall expedite processing those Hotline allegations that are **time-sensitive.** Necessary controls shall be maintained to protect, to the maximum extent, the identity of all DoD Hotline users who request anonymity.

3. Audit working papers and files on Hotline reviews shall generally be retained for at least 3 years after an audit is **completed** before being disposed of under applicable DoD or agency regulations. Reports shall be **submitted** in accordance with subsection F. 3 of DoD Directive 7050.1 (reference (tt)).

J. RELATIONS WITH DOD CRIMINAL INVESTIGATIVE ORGANIZATIONS

1. Close cooperation between auditors and investigators is critical to successful investigation and prosecution of fraud. Once the auditor finds indications of **potential** fraud, the organizational fraud monitor shall be notified and contact should be made with representatives of the appropriate DoD investigative organization.

2. As discussed in paragraph F. 3. f. above, after developing sufficient fraud indicators, the auditor shall formally refer the matter to the **appropriate** investigative organization. The DoD audit organization should subsequently follow up to keep track of the disposition of the fraud referral. Under the provisions of Joint Policy Memorandum Number 2 (reference (rr)), DoD criminal investigative organizations are required to assist the audit organizations by providing **periodic** status on referrals made from auditors.

3. The DoD audit organizations should **respond** timely when investigative organizations request audit assistance in performing formal investigations. Related audit working papers should be provided to the investigative organization if required. Guidelines for audit support of fraud investigations are outlined in Enclosure 2.

4. Most DoD investigative organizations periodically conduct "crime prevention surveys" to identify administrative, **physical**, or internal control weaknesses that allow the commission of fraud or illegal acts. The DoD audit organizations should request that they be placed on distribution for such survey reports, and consider the results of the reports in scheduling **audits.**

5. Internal audit **organizations** are urged to participate with investigative organizations in joint reviews of programs and operations highly susceptible to fraudulent activities. At a **minimum, auditors** should contact their investigative counterparts in the survey or planning stage of an audit to discuss the susceptibility of a particular area to **fraud** and ascertain whether there are any ongoing or **completed** investigations of the area that would be of interest to the auditor.

6. Internal audit organizations are encouraged to assist criminal investigative organizations by providing **information** they may come across during their audits (**information** referrals) that could alert investigators to weaknesses in internal controls and to procedures that could create conditions conducive to **fraud**, even though no **fraud** may actually be suspected. One technique for doing this is to highlight findings **from audit** reports and provide these under a cover memorandum to the investigative organization. This suggested procedure is **considered** to be a more effective way of actually bringing specific weaknesses to the attention of investigators than by merely relying on the **routine** distribution of audit reports to the investigative organizations.

K. ADDITIONAL GUIDANCE

The General Accounting Office (GAO) has published a pamphlet, dated December 1989, entitled "Assessing **Compliance** with Applicable **Laws** and Regulations, " (reference (uu)) that provides additional guidelines for implementing **Government Auditing Standards** (reference (c)) related to fraud and illegal acts. The guide was **prepared** to help the GAO staff implement the **strengthened** requirement for detecting **noncompliance**. The provisions of the guide are equally **applicable** to the work of **DoD** internal **auditors** in evaluating **noncompliance** and designing audit steps to detect instances of fraud, abuse, and illegal acts.

SELECTED SOURCES OF INFORMATION
ON FRAUD AND FRAUD INDICATORS

1. "Indicators of **Fraud** in Department of Defense Procurement," IG, **DoD** 4075. 1-H, Office of the Inspector General, **DoD**, June 1987.
2. "Fraud Awareness Letter, " Off ice of the Inspector General, Dal), published quarterly.
3. "**Common** Violations of the United States Code in **Economic** Crime Investigations, " U.S. Criminal Investigation **Command**, November 15, 1983.
4. "Manual for Fraud Investigations (**NIS-6**) ," Naval Investigative Service, October 1983.
5. "Fraud **Indicators** Handbook, " U.S. Marine Corps, June 27, 1983.
6. "**Indicators** Handbook, " Air Force **Audit**, Inspection and Investigative Council, June 4, 1986.
7. "Crime Prevention Survey Technical Guidelines Handbook," Defense Logistics Agency, **October** 1983.
8. "Fraud **Indications** in **AAFES** Operations ," Headquarters, Army, Air Force Exchange Service, Safety and Security Division, 1981
9. "**Developing** Fraud Awareness in Management ," Off ice of the Inspector General, Services Administration, December 1980.
10. "Codification of Statements on Auditing Standards," American Institute of Certified Public Accountants, 1989.
11. "Handbook on Labor Fraud Indicators, " Off ice of the Inspector General, DoD, August 1985.
12. "Handbook on Scenarios of Defective Pricing Fraud ," Off ice of the Inspector General, **DoD**, **December** 1986.
13. "Handbook on Fraud **Indicators**: Material," Off ice of the **Inspector** General, **DoD**, **July** 1986.
14. "Unauthorized Quality Assurance Practices **by** Contractors ," **IGDH** 4000.50, Off ice of the Inspector General, DoD, **May** 1988.
15. "Criminal Defective Pricing and the Truth in Negotiations Act, " **IGDPH** 4200.50, Office of the Inspector General, **DoD**, March 1988.
16. "**Compendium** of Publications on **Fraud**, Waste, and Abuse Indicators ," President's Council **on** Integrity and Efficiency, June 30, 1988.
17. "Fraud Awareness Concepts for Department of Defense Quality Assurance Personnel, " Off ice of the Inspector General, DOD, May 1, 1985.

18. "Role of the Contract Auditor in Criminal Investigations, " **IGDH** 7600.2, Office of the Inspector General, **DoD**, January 1989.
- 19* 'Fraud-Related Audit/Investigative Publications, " President's Council on Integrity and Efficiency, April 7, **1989**.
20. "Directory of Internal **Audit** Programs, " **IGDD** 7000.1, Office of the Inspector General, **DoD**, June 1989.
21. "Assessing **Compliance** with Applicable Laws and Regulations, " **General** Accounting Office Pamphlet, **December** 1989.

GUIDELINES FOR AUDIT SUPPORT OF FRAUD INVESTIGATIONS

1. Introduction

a. The DoD criminal investigative organizations frequently request support from DoD audit organizations. Audit support to criminal investigations as authorized by paragraph F. 6a. of DoD Directive 7600.2 (reference (k)), and encouraged by the provisions of this chapter, furthers significant DoD interests. Such support facilitates the identification of information and evidence needed for the effective accomplishment and coordination of criminal, civil, administrative, and contractual remedies. Audit support may include the provision of audit advice; the transmission of results or information obtained during separate, cooperative, or coordinated audit activity initiated by the audit organization; or on occasion, the assignment of auditors to a team investigating a suspected irregularity.

b. From time to time questions have arisen concerning various aspects of the relationship created by an auditor's cooperation/coordination with, or assignment to, an investigative team. The purpose of this enclosure is to provide general guidelines regarding the most frequently encountered issues concerning audit support of investigations and, in particular, to address the issues that arise as a result of an auditor's assignment to an investigative team. Additional guidelines are contained in IG, DoD, Handbook IGDH 7600.2 (reference (w)), that may be useful in those instances where the internal auditor is involved with examining contractor records and fraud is suspected.

2. Requests for Audit Support

a. The DoD audit organizations should require all requests for audit support from a criminal investigative agency to be in writing. When the request stems from a prior referral made by the audit organization, the request should be directed to the same organization initiating the fraud referral for which the investigation is being undertaken. When no fraud referral was involved in initiating the investigation, the request for audit support should be directed to the DoD audit organization that has primary audit cognizance, under DoD Directive 7600.2 (reference (k)), for the organization, activity, contract, or contractor under investigation. The DoD internal audit organizations, in consultation with the investigative organization, should formulate a list of the audit tasks needed to support the investigation.

b. The list of audit tasks should be updated and amended from time to time depending on investigative developments, or as the audit organization deems necessary to properly fulfill its mission or functions.

c. When a DoD audit organization elects to conduct an audit after a request for support by a DoD criminal investigative organization, steps to accomplish the requested tasks should be included in the audit program, and the audit should be conducted in cooperation with the requesting organization. A final decision on how the audit results will be reported rests with the audit organization, although it should defer to any request to withhold reporting if it would interfere with the investigative/ judicial process.

3. Selection and Assignment of Audit Personnel to Investigative Teams

a. Occasions will arise when it will **become** necessary to assign an auditor to act as a member of an investigative team. Selection of an auditor. in this situation is a matter for determination by the respective audit **organization**. Audit officials making the selection should take into account such factors as a specific name request by the investigative or prosecutive organization; future anticipated **assignments** of the potential selectee(s); special skills or work experience that may be required as a member of the investigative team; professional credentials of the possible selectee(s) (Certified Public Accountant , Certified Internal **Auditor**, Certified Information Systems **Auditor**, Certified Fraud Examiner, etc.); and the desires of potential selectees to serve on the investigative effort.

b. Any disagreements between the audit and investigative organizations regarding the need for audit support or which **auditors** will be assigned to an investigative team shall be referred to the **head** of the internal audit activity. Every effort shall be made to find a mutually acceptable solution without compromising required **audit independence**. If such a solution **cannot be found**, the matter should be elevated through the chain of **command** to the IG, DoD, for a decision. Where the disagreement exists between an internal review element and an investigative activity of the same **Component**, the matter need not be referred to the IG, **DoD**, but should be resolved within the **Component**. **Generally, requests** for audit support should be handled by the audit organization of the **Component** requesting the assistance.

4. Role of the Auditor on the Investigative Team

a. The **auditor** shall not perform clerical or other nonprofessional services on behalf of the investigators. The investigative organization has the **responsibility** for arranging for adequate clerical resources. Audit resources **should** be conserved whenever possible. The auditor should request clerical support when certain procedures can be organized and performed by **nonauditors** under the general supervision of the auditor. An example **would** be the **examination** of a large **volume** of **documents** for indications of erasures, **whiteouts**, or other alterations.

b. The **auditor** shall **not** undertake duties that are traditionally the role of the criminal investigator.

c. To the extent that information **obtained** by **auditors** is not a matter occurring before a grand jury, and thus covered by Rule 6 (e) of the Federal Rules of Criminal Procedure on grand jury secrecy, the information may be shared for both audit and **investigation purposes**. (Paragraph 8 contains additional guidance on grand jury proceedings.)

5. Handling Documentary Evidence

a. The **DoD** audit organizations, in the **performance** of their official **responsibilities**, are likely to accumulate audit working papers that would be of use to **DoD** criminal investigative organizations. Such working papers should be made available **for** inspection and copying by the investigative organization upon request. Working papers generated as part of an investigative assist should normally be turned over to the investigative team.

b. The **DoD** audit organizations may occasionally obtain, in connection with their official duties, custody and control of original documents, including contractor records, that reflect indicators of fraud or other unlawful activity. When an audit organization becomes aware of potential fraud or other unlawful activity, it should immediately notify the applicable criminal investigative agency in order that appropriate measures can be taken for the Government to maintain custody and control of the documents that may be needed as evidence in subsequent criminal proceedings.

6. Notice to an Auditee and Response to Inquiries

a. The decision on whether to inform an auditee that an audit is being conducted in connection or coordination with a criminal investigation is the responsibility of the cognizant investigative agency in consultation with the Department of Justice prosecutor as necessary.

b. Auditors who are assigned to a criminal investigative team will not, in any way, cover up the fact that they are working with a criminal investigative effort if they are asked specifically what they are doing.

7. Obtaining Necessary Records

a. Records and information needed to conduct an audit in support of an investigation can be obtained by various means including, but not limited to, the access-to-records clause of a contract, voluntary disclosure by the auditee, Inspector General subpoena (in the case of nonfederal records), search warrant, and grand jury subpoena.

b. An auditor assigned to an investigation will not use his position to gain access to information or documents unless that information would normally be available to the audit organization in performing its mission. If the investigation requires documents that are not available under that audit organization's existing authority, those documents will be obtained through other authorities.

8. Grand Jury Investigations

a. Rule 6 (e) of the Federal Rules of Criminal Procedure requires matters occurring before a grand jury to be kept secret. An auditor involved in an investigation of this type must obtain, and act in accordance with, guidance from the cognizant Assistant United States Attorney or his designee in addition to the minimum guidance provided herein.

b. The following criteria should be followed to prevent even the appearance that matters occurring before a grand jury may have been improperly disclosed to support DoD audit functions:

(1) An auditor while assigned to a criminal investigation being pursued under grand jury auspices will not be involved in any other audit that in any manner relates to the matter under investigation. This precept should be kept in mind when selecting an auditor to serve on such an investigative team.

(2) An audit supervisor should not continue to exercise normal audit responsibilities for a contractor or entity when that audit supervisor is designated as a member of a grand jury investigative team examining matters

related to the same contractor or entity. The audit supervisor will not resume audit responsibility for the contractor or entity until **completion** of the criminal investigation and all related criminal prosecutions brought by the United States Government.

(3) Audit organizations should, when **possible**, use auditors as witnesses rather than having them made agents of the grand jury. By carefully structuring the role of an auditor in this regard, it may be possible to limit adverse impact of grand jury secrecy on the auditor's normal duties and responsibilities.

GUIDELINES FOR COORDINATION AND FEEDBACK ON FRAUD REFERRALS

1. Introduction

Coordination between **DoD audit** and criminal. investigative organizations is necessary to carry out effectively their responsibilities for **DoD** programs. Adherence to the procedures and guidelines provided in this enclosure will enable the audit organizations to plan better for audit resources that may be needed in pursuing issues **raised** in referrals and in providing support for, or working in connection with, **DoD** criminal investigative organizations. Feedback obtained as part of the **coordination** process will also enable the audit organizations to **more** effectively evaluate and improve their future referrals. The enclosure also provides guidelines for **audit** organizations to **follow** in continuing audit activity while an investigation is pending.

2. Procedures

a. The **DoD** audit organizations shall:

(1) Encourage dialogue between audit and instigative field personnel regarding the need for and content of referrals for suspected or potential. f **raud**.

(2) Ensure that **auditors** performing contract audits will not make reference to or discuss with the contractor the fact that a fraud referral has been made. Further, no atteinctp will be made by the **auditors** to resolve with the contractor their suspicions that possible f **raud** has **occurred**. Discussions will be limited to the **auditor's judgments** and conclusions on matters other than fraud, and to the underlying facts that support those judgments and conclusions.

(3) Ensure that internal. auditors follow restrictions outlined in paragraph F. 3 .g. of this chapter on notifying officials of the entity under audit of suspected fraud where the officials **may be** a party to or implicated in the fraud.

(4) Ensure that after making a referral of suspected fraud or after notification of the initiation of an investigation, no **actions** are taken that would **compromise** the investigation. The audit swpe may, after consultation with the investigative organization, be expanded to determine the impact of the suspected fraud or other unlawful activity on the **audit** objectives. Audit scope, however, shall not be expanded for the **sole** purpose of gathering additional information (after a referral is made) to **support** an investigation into **suspected** fraud or other unlawful conduct. Audit activities outside the area of investigative interest can continue unless a request **from** the investigative organization **recommends** a deferral for investigative reasons. If the auditor believes the requested deferral will result in financial harm to the Government or will unnecessarily impede the audit mission, the matter shall be elevated for management resolution between the respective organizations.

(5) Ensure that when an audit report is issued for any **audit** in which there has **been** a related referral to a criminal investigative organization, the audit report includes or is **accompanied** (under separate transmittal **memorandum**)

by a statement of cautionary language regarding the existence of the referral or an investigation resulting from the referral. **Legal** counsel should be contacted for advice on reporting where there are any statements contemplated with regard to fraud, illegal acts, or pending/ongoing investigations.

(6) Ensure coordinated action between the audit organization's fraud **monitor and** appropriate field personnel. The field personnel will ensure that the organizational fraud monitor is kept apprised of all referrals. Field audit personnel will also provide the designated fraud monitor with copies of status information received **from** applicable investigative organizations on matters previously referred to investigators.

(7) Establish procedures for making referrals that assign a unique identifying number to each referral and enable the referral to be tracked through an **automated** system.

(8) Assess the information received regarding investigations conducted based on audit referrals in order to identify lessons learned, and use that information to develop more effective audit techniques and tests that will help disclose the existence of similar situations in other audits.

DOD DIRECTIVES AND FEDERAL STATUTES
GENERALLY APPLICABLE TO CRIMINAL REFERRALS AND
STANDARDS OF CONDUCT REFERRALS

Presented below is a brief outline of DoD directives and federal statutes generally applicable to criminal referrals or Standards of Conduct referrals. Auditors should obtain legal counsel whenever questions exist on the applicability or interpretation of laws or implementing regulations.

DoD Directives:

DoD Directive 5500.7, "Standards of Conduct," May 6, 1987? prescribes standards of conduct required of all DoD personnel regardless of assignment. It establishes criteria and procedures for reports required of certain former and retired military officers and former DoD civilian officers and employees who are presently employed by defense contractors, and former officers and employees of defense contractors presently employed by the Department of Defense.

Federal Statutes:

1. Sherman Antitrust Act, 15 U.S. c. 1. This Act prohibits competitors from entering into any agreement to restrain trade in interstate commerce, including price fixing, bid rigging, and bid rotations schemes.

2. Bribery, Graft, and Conflicts of Interest, Generally 18 U.S. c. 201-209. These statutes prohibit a broad range of activities that can be generally described as corruption. Such activities include giving or receiving a bribe or **gratuity**, as **well** as engaging in a conflict of interest.

a. Bribery includes giving a Government employee something of value for the purpose of influencing the performance of that employee's duty.

b. Gratuities include giving a Government employee something of value because of the employee's official position. There is no requirement for the Government to prove that the gratuity was given for the purpose of influencing any official act.

c. Conflicts of interests include those situations where a Government employee engages in activities which create a conflict between the employee's personal interests and his or her duty to protect and serve the interests of the Government.

3. Voiding Contracts, 18 U. S.C. 218. Federal agencies have the authority to void and rescind contracts obtained through bribery, **graft**, or **conflicts of interest**.

4. Conspiracy to Defraud the Government With Respect to Claims, 18 U.S.C. 286. Whoever enters into any agreement or conspiracy to defraud the United States by obtaining the payment of any false or fraudulent claim, shall be fined not more than \$10,000 or imprisoned not more than 10 years, or both.

5* False Claims, 18 U.S.C. 287. This statute makes it illegal to present or make any false, fictitious,, or fraudulent claim against any department or agency of the United States. The crime is complete when the claim is presented. Payment of the claim is not an element of the offense and need not be proven to obtain a conviction.

6. Conspiracy, 18 U.S.C. 371. This statute prohibits any agreement between two or more persons to defraud the United States or to violate any Federal law or regulation when at least one act is taken in furtherance of the agreement.

7. Theft, Embezzlement, or Destruction of Public Money, Property, or Records, 18 U.S.C. 641. This statute prohibits intentional and unauthorized taking, destruction, or use of Government property or records. It also prohibits receiving or concealing such property or records.

8. False Statements, 18 U.S.C. 1001. This statute makes it illegal to engage in any of the three types of activity listed below in any matter within the jurisdiction of any department or agency of the United States.

a. Falsifying, concealing, or covering up a material fact by any trick, scheme, or device;

b. Making false, fictitious, or fraudulent statements or representations; or

c. Making or using any false documents or writing. Any certification in a DoD contract that contains false, fictitious, or fraudulent information may be a violation of this statute.

9. Mail Fraud, 18 U.S.C. 1341, and Wire Fraud, 18 U.S.C. 1343. These statutes make it illegal to engage in any scheme to defraud in which the mail or wire communications are used. Use of the mail or wire communications includes sending or receiving any matter through the use of these mediums. .

10. Obstruction of Federal Audit, 18 U.S.C. 1516. Whoever, with intent to deceive or defraud the United States,, endeavors to influence, obstruct, or impede a Federal official in the performance of official duties relating to a person receiving an excess of \$100,000, directly or indirectly from the United

States, in any 1 year period under a contract or subcontract, shall be fined under that title or imprisoned not more than **5-years**, or both. A Federal auditor is defined as any person employed to perform an audit or quality assurance inspection for or on behalf of the United States. This section was intended to prohibit a wide range of obstructive conduct, such as destruction or fabrication of documents as well as intimidation of witnesses and contractor employees.

11. Trade Secrets Act, 18 U.S.C. 1905. This statute prohibits unauthorized release of any information relating to trade secrets or confidential business data by a Federal employee **who receives** such information in the course of his employment. **Such** information includes advance procurement information, prices, technical proposals, proprietary information, income information, etc.

12. Racketeer-Influenced and Corrupt Organizations Act, 18 U.S.C. 1961-1968. This statute was aimed at traditional organized crime activities but is applicable in situations involving fraud in Federal agencies. "Racketeering" is defined **as** any number of offenses under Federal law, including those discussed above. The statute is applicable to "enterprises," including an individual, partnership, corporation, association, or other legal entity.

13. Anti-kickback Act, 41 U.S.C. 53-55. This Act makes it a crime for any person to provide, attempt to provide or offer any fee, commission, compensation, gift or gratuity to a prime contractor or any higher tier subcontractor, or an employee of one of these, for the purpose of improperly obtaining favorable treatment under a Government contract.

14. Federal Procurement Policy Act, 41 U.S.C. 423. Effective July 16, 1989, Section 27 (entitled "Procurement Integrity") of the Act prohibits certain-actions by government officials employees, consultants and advisors, and those of competing contractors during the conduct of any Federal agency procurement of property or services. All "**procurement** officials" are required to certify that they are familiar with certain provisions of the law, that they will not violate these provisions, and that they will report immediately to the contracting officer any information concerning a violation or potential violation. Administrative, civil, and criminal penalties are prescribed for violations of the Act's provisions.

15. Forfeiture of Fraud Claims, 28 U.S.C. 2514. A claim against the United States shall be forfeited to the United States by any person who corruptly practices or attempts to practice any fraud against the United States in the proof, statement, establishment or allowance thereof. In such cases, the United States Claims' Court shall specifically find such fraud or attempt and render judgement or forfeiture.

16. False Claims Act, 31 U. S.C. 3729. A person is liable for a civil penalty of not less than \$5,000 and not more than \$10,000, plus three times the amount of damages which the government sustains if the person knowingly presents a false or fraudulent claim for payment, or knowingly makes a false record or statement to get a false or fraudulent claim paid or approved by the government. The statute defines knowingly as having actual knowledge of the information, acting in deliberate ignorance of the truth or falsity of the information, or acting in reckless disregard of the truth or falsity of the information.

17. Program Fraud Civil Remedies Act, 31 U.S. C. 3801. The Act was passed by Congress in 1986 because too often low-dollar false claim cases and cases involving false statements are declined for criminal or civil prosecution by the Department of Justice (DOJ), leaving the Government without an effective alternate remedy. The Act applies to false statement cases and claims made on or after October 21, 1986, involving a false submission of \$150,000 or less where the DOJ has declined to prosecute. A defendant found liable by the presiding officer can be assessed a penalty of up to \$5,000 for each false claim or false statement, and an additional money penalty in claims cases up to twice the amount falsely claimed.